

REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MUSINA LOCAL MUNICIPALITY FINANCIAL STATEMENTS

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Musina Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages xx to xx

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment (PPE)

7. My audit revealed a significant number of assets belonging to the municipality which were not accounted for in the accounting records and financial statements. The value of these assets could not be quantified. Consequently, I could not determine the effect on the PPE balance of R106 186 354 (2010: R98 113 312 as disclosed in note 10 to the financial statements).
8. The municipality's accounting records did not facilitate easy identification and location of assets recorded in the financial statements. As a result, tangible capital assets amounting to R11 464 181 included in the financial statements could not be physically verified. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence and the rights to these assets.
9. Standards of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment* requires cost to be measured at fair value at the date of acquisition, where an asset is acquired at no cost or for a nominal cost. The municipality acquired assets from its municipal entity during the year under review at no cost. These assets were accounted for at carrying value instead of fair value as required in terms of the above requirement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of PPE amounting to R2 587 377 in the financial statements.
10. The municipality did not review the useful lives and residual values of property, plant and equipment at the reporting date in accordance with Standards of Generally Recognised Accounting Practice, GRAP 17, *property, plant and equipment*. Consequently, I was unable to determine the effect on the surplus for PPE for the period and accumulated surpluses in the financial statements.
11. Standards of Generally Recognised Accounting Practice, GRAP 17, *property, plant and equip, equipment* requires that an item of PPE should be separated into parts or components, when those parts or components are significant in relation to the total cost of the item. It is further required that each of these individual parts or components be depreciated separately. Included in PPE in the financial statements is infrastructure assets amounting to R16 616 630 (2010: R15 499 360) for which the municipality did not identify and separate into parts or components as per the above requirement. Because of the

nature of these assets, I was unable to confirm or verify by alternative means the value of infrastructure assets included in the financial statements at R31 197 870 (2010: R28 533 721) and the related accumulated depreciation and depreciation amounts of R14 581 239 (2010: R13 034 361) as disclosed in note 10 to the financial statements. Consequently, I did not obtain sufficient appropriate evidence to satisfy myself as to the existence, rights and valuation of infrastructure assets.

Trade and other receivables

12. Included in the other receivables balance in note 15 to the financial statements, is an amount of R 3 044 137 (2010: R2 564 276) due from the district municipality from water related transactions. The district municipality did not confirm this balance and as a result I could not obtain sufficient appropriate audit evidence with regard to existence, valuation and allocation, completeness and rights pertaining to this balance. I also could not determine the effect on the other account balances or classes of transactions contained in the financial statements.

Trade and other payables

13. Included in trade and other payables balance in note 8 to the financial statements, R66 151 366 (2010: R50 916 632), is an amount payable of R12 722 187 for the district municipality in respect of water related transactions. The district municipality did not confirm this balance and as a result, I could not obtain sufficient appropriate audit evidence with regard to existence, valuation and allocation, completeness and obligations pertaining to this balance. I also could not determine the effect on the other account balances or classes of transactions contained in the financial statements.
14. Included in the other creditors balance in note 8 to the financial statements are retention payables amounting to R1 014 540. The municipality could not provide supporting documentation for this balance. The entity's records did not permit the application of alternative audit procedures regarding this amount. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, valuation and allocation and completeness of the retention payables balance of R1 014 540 included in the financial statements.

Revenue

15. The municipality did not charge re-connection fees as per the approved tariffs on reconnection of consumers who were disconnected due to accounts in arrears. Due to the volume of reconnections which occurred during the year, I was unable to perform alternative procedures to determine the value of such revenue. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the accuracy and completeness of revenue from re-connection fees amounting to R54 640 848 as disclosed in the financial

statements.

16. The municipality did not update the changes which resulted from the rezoning and improvements of properties in the valuation roll and other underlying accounting records. Due to the volume of these changes, I was unable to perform alternative procedures to determine the value. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the completeness and accuracy of the property rates of R10 452 708 (2010: R9 457 596) as disclosed in note 18 to the financial statements.

Commitments

17. The municipality did not have an adequate contract management system in place for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. The basis used to calculate these commitments disclosed in the financial statements were also incorrect as the municipality used estimated expenditure instead of the contracted amount less expenditure incurred. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of commitments of R21 099 645 (2010: R24 874 141), as stated in note 37 to the financial statements

Opinion

18. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Musina Local Municipality for the year ended 30 June 2011 financial performance and its cash flows for the year then ended are prepared, in all material respects, in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the MFMA.

Emphasis of matter

19. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

20. As disclosed in note 33 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of an error discovered during 2011 in the financial statements of the Musina Local Municipality at, and for the year ended, 30 June 2010.

Fruitless and wasteful expenditure

21. As disclosed in note 45.2 to the financial statements, fruitless and wasteful expenditure of R19 256 017 was incurred as follows:

- R12 000 000 incurred by funding and sustaining the operations of its municipal entity since inception
- R657 033 incurred on a consulting firm for services not rendered
- R6 570 450 due to the municipality failing to honour a contractual agreement with a contractor.

Unauthorised expenditure

22. As disclosed in note 45 to the financial statements, unauthorised expenditure to the amount of R6 160 953 due to conditional government grants utilised for purposes other than intended for.

Irregular expenditure

23. As disclosed in note 45.1 to the financial statements, irregular expenditure to the amount of R37 612 125 was incurred due to deviations from supply chain management prescripts.

Additional matters

24. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

25. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

26. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in Government Gazette 33872 of 15 December 2010, I include below my findings on the annual performance report as set out on pages xx to xx and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

27. I could not conduct the audit of performance against predetermined objectives as the Musina Local Municipality did not submit the annual performance report as required by section 46 of the MSA, section 121(3)(c) of the MFMA and part C of *General notice 1111 of 2010*, issued in *Government Gazette No. 33872 of 15 December 2010*.

Compliance with laws and regulations

Annual financial statements

28. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements

identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a qualified audit opinion.

Audit committees

29. The audit committee did not function as required by section 166(2)(b) of the MFMA, in that the audit committee did not adequately review the accuracy and completeness of the annual financial statements, as these annual financial statements and the annual performance report were subject to material adjustments.

Procurement and contract management

30. Awards were made to providers who are persons in service of other state institutions in contravention of the requirements of SCM regulations 44. Furthermore the service provider failed to declare that he/she is in the service of the state as required by SCM regulation 13(c)
31. Goods and services with a transaction value of between R10 000 and R500 000 were procured without inviting at least three written price quotations from prospective suppliers, as per the requirement of SCM regulations 12(1)(c) and 17(1)(a).

Expenditure management

32. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
33. The accounting officer did not take reasonable steps to prevent unauthorised, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
34. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounted for creditors of the municipality, as required by section 65(2)(b) of the MFMA.

Asset management

35. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register) as required by section 63(2)(c) of the MFMA.

INTERNAL CONTROL

36. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified of opinion, the findings on the annual performance report and the

findings on compliance with laws and regulations included in this report

Leadership

- The chief financial officer did not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls
- The accounting officer did not implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored
- The accounting officer did not establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes, and responsibilities
- The chief financial officer did not develop and monitor the implementation of action plans to address internal control deficiencies
- The accounting officer did not establish an IT governance framework that supports and enables the business, delivers value and improves

Financial and performance management

- The accounting officer did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting
- The chief financial officer did not implement controls over daily and monthly processing and reconciling of transactions
- The chief financial officer did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information
- The accounting officer did not review and monitor compliance with applicable laws and regulations
- The accounting officer did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.

Governance

- Those charged with governance did not ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations

OTHER REPORTS

Investigations

Investigations in progress

37. An investigation is being conducted by a firm appointed by the department of Cooperative Governance, Human Settlement and Traditional Affairs to probe into the manner of the awarding of tenders in terms of the municipality's supply management policies and procedures. The investigation was still ongoing at the reporting date.

Auditor General

Polokwane

30 November 2011



AUDITOR - GENERAL
SOUTH AFRICA

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